Supreme Court, U.S.
FILED
MAR 6 1992
OFFICE OF THE CLERK

No. 90-1918

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

KRAFT GENERAL FOODS, INC.,
Petitioner,
v.
IOWA DEPARTMENT OF REVENUE AND FINANCE,
Respondent.

On Writ of Certiorari to the Supreme Court of Iowa

BRIEF OF AMICI CURIAE AVON PRODUCTS, INC., COLGATE-PALMOLIVE CO., DOLE FOOD COMPANY, INC., BF GOODRICH CO., H.J. HEINZ CO., REXAIR, INC., AND STERLING WINTHROP, INC. IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST [1]

Amici are domestic multinational companies that participate extensively in foreign commerce. Although *amici* represent different industries, they share certain interests. First, each of these businesses has one or more foreign subsidiaries, and when those subsidiaries declare dividends, they are subject to, or potentially subject to, the type of discriminatory treatment imposed by Iowa on Petitioner Kraft in this case.

[1] The parties' letters of consent have been filed with the Clerk pursuant to Rule 37.3 of this Court.

Additionally, as large enterprises with longstanding overseas commitments, *amici* have an abiding interest in the protections of the foreign commerce clause and the equal protection clause. In this increasingly competitive and global marketplace, the Constitution's protection against parochial and misguided discriminatory treatment of foreign commerce takes on special importance.

SUMMARY OF ARGUMENT

The commerce clause issues in this case boil down to two simple questions: may a state discriminate against foreign commerce, provided only that it does not advance purely local interests as a result? And may asserted "administrative convenience" justify a state law that facially discriminates against foreign commerce?

The State of Iowa insists that its discrimination against foreign commerce is not invidious under the foreign commerce clause because it does not favor local interests at the expense of their foreign competitors. This theory is untenable: the purpose of the foreign commerce clause (U.S. Const. art. I, § 8, cl. 3) is to prevent state interference with commerce among nations, and the burden of discriminatory legislation is not lightened in any way by the State's pursuit of a discriminatory objective that benefits domestic commerce as a whole. Furthermore, facial discrimination against foreign commerce cannot be justified absent the State's demonstration that it has important ends which cannot be served through other, nondiscriminatory means. Certainly, mere speculative claims of administrative convenience cannot save the Iowa statutory scheme from invalidation.

Nor is administrative convenience sufficient to satisfy the requirements of the equal protection clause (U.S. Const. amend XIV, cl. 1), even under the least substantial scrutiny. At issue here is what amounts to a claim that the administrative convenience of retaining the current

version of the Iowa tax form justifies the discrimination. This Court has never held that a state's unwillingness to alter its tax form is adequate justification for preferring one class of taxpayers over another. Even if the taxing scheme could pass rational basis scrutiny, which we think it could not, a higher level of scrutiny is appropriate here, where a facially discriminatory statute implicates foreign commerce—a clear constitutional concern. A close look is particularly appropriate when, as here, state legislators are not politically accountable to those who must bear the burden of the discriminatory tax.

ARGUMENT

Under the Iowa taxing scheme, the State of Iowa borrows heavily, although not entirely, from the federal Internal Revenue Code. Under the Code, to arrive at net income a taxpayer deducts a certain percentage of dividends received from *domestic* subsidiaries: if the taxpayer owns 80 percent or more of a domestic subsidiary, it is allowed a 100 percent tax deduction for the dividends received from these "affiliated" subsidiaries. 26 U.S.C. §§ 243, 1504 (1988), *as amended by* Pub. L. 101-508, 104 Stat. 1388 (1990). Under the Code, taxpayers claim a credit for the taxes paid on dividends received from foreign subsidiaries. 26 U.S.C. §§ 901, 902.[2]

Iowa's Tax Code imports the federal Code's definition of "net income," thereby excluding from the state's income tax base all dividends received from "affiliated"

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[2] The federal Code (26 U.S.C. § 164(a)(3) (1988)) permits a taxpayer to elect to treat tax on foreign source income as a deduction instead of as a credit in some circumstances. *See* Opp. 1; Pet. App. 31a. Although a taxpayer electing to deduct foreign taxes paid would, due to Iowa's importation of the federal "net income" figure, reduce the discriminatory effects at the state level, the costs at the federal tax level could be very high. Joseph Isenbergh, I *International Taxation* ¶ 17.1.1 (1990). In effect, Iowa offers reduced discrimination only if a taxpayer elects to sacrifice substantial rights under federal law.

domestic subsidiaries, but *including* all foreign-source dividends. Iowa Code Ann. § 422.35 (West 1990 & Supp. 1991). Although the Iowa Tax Code provides a number of credits and other adjustments to net income, Iowa does not (unlike the federal Code) allow a credit for taxes paid to foreign countries. This results in discriminatory treatment of foreign-source income in violation of the foreign commerce and equal protection clauses.

The complexities of the tax statutes, both at the federal and state levels, should not be allowed to obscure the practical essence of this case. The discrimination against foreign commerce effected by Iowa's tax scheme is stark. When a corporate taxpayer receives dividends from a *domestic* corporation, Iowa law, as a general matter, does not tax the recipient at all on those dividends, or taxes only a small fraction. When an otherwise identically situated corporate taxpayer receives dividends from a *foreign* corporation, the dividends are taxable in full. It is as if Iowa simply imposed a tariff on the receipt of dividends from sources outside the United States. If this policy is sensible from the standpoint of this country's national interests, the decision to implement such a policy is a matter for the federal government, not the State of Iowa.

I. IOWA'S TAX TREATMENT OF FOREIGN-SOURCE INCOME IMPERMISSIBLY DISCRIMINATES AGAINST FOREIGN COMMERCE

Iowa asks this Court to expand states' ability to interfere with foreign commerce by ruling first, that Iowa may permissibly discriminate against such commerce so long as it does not advance purely local interests in the balance, and second, that administrative convenience can justify a state law that facially discriminates against foreign commerce. The Court should decline the invitation to alter its prevailing jurisprudence.

The State concedes that its tax provisions treat dividends of foreign subsidiaries differently from dividends

of domestic subsidiaries, and essentially concedes that this works actual discrimination against unitary businesses that receive dividends from foreign subsidiaries. Opp. 10.[3] The State argues, however, that it may permissibly discriminate against foreign commerce as long as "[t]here is no direct commercial advantage to local Iowa business at the expense of non-Iowa business" as a result. Opp. 10.[4] The court below adopted this curious theory,[5] but the test founders because it takes no account of the purpose and practical effect of the foreign commerce clause, which prevents state interference with foreign commerce *regardless* of whether purely parochial interests are advanced by discriminating against such commerce.

This Court has long acknowledged that one "compelling reason" for the Constitutional Convention of 1787 was that, under the Articles of Confederation, "the individual States [were] free to burden commerce both among themselves *and with foreign countries* very much as they pleased." *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 283 (1976) (emphasis added). As Chief Justice Marshall wrote from experience as an eyewitness,

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[3] The State does not contest Kraft's demonstration that "Iowa subjects a corporation receiving a $100,000 foreign subsidiary dividend to a greater tax than an otherwise similarly situated corporation receiving a $100,000 domestic subsidiary dividend" (Pet. 6), and the State's own hypotheticals demonstrate that its tax statutes create a "difference in treatment of the dividends" of foreign and domestic subsidiaries, and that this creates a "corresponding difference in treatment of" two otherwise similarly situated unitary businesses. Opp. 10.

[4] *See also, e.g.*, Opp. 11 (because Iowa's discriminatory treatment of foreign-source dividends "does not favor Iowa activities over those which cross state lines and does not encourage or protect the conduct of activities in Iowa, the Iowa tax structure does not discriminate against foreign commerce in violation of the Commerce Clause").

[5] "Kraft must show, as in the case of alleged interstate discrimination, that Iowa businesses receive a commercial advantage over foreign commerce due to Iowa's taxing scheme." Pet. App. 7a.

> The oppressed and degraded state of commerce previous to the adoption of the constitution can scarcely be forgotten. It was regulated by foreign nations with a single view to their own interests; and our disunited efforts to counteract their restrictions were rendered impotent by want of combination.

Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 445-46 (1827).

To address these evils, which had prevented the formation of a coherent nation out of disparate parts, the Framers provided that the national government should have substantial control over both interstate and foreign commerce. *H.P. Hood & Sons v. DuMond*, 336 U.S. 525, 533-35 (1949). Inherent in this affirmative grant of authority is an implied limitation on state interference with commerce involving business beyond state borders. *Id.* at 535. The interstate commerce clause[6] prevents states from interfering with the free flow of goods among the states, and invalidates state laws that favor local interests at the expense of interstate businesses. "[W]hat is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation." *Baldwin v. Seelig*, 294 U.S. 511, 527 (1935).

The foreign commerce clause,[7] in turn, prevents states from interfering with commerce among the nations by "burden[ing] commerce . . . with foreign countries very much as they please[,]" *Michelin*, 423 U.S. at 283, and allows the nation to avoid "disunited efforts" when addressing commerce with other countries. *Brown*, 25 U.S. (12 Wheat.) at 445-46. "Those who felt the injury arising from this state of things [prior to adoption of the

[6] "The Congress shall have the Power . . . To regulate Commerce . . . among the several States . . . ." U.S. Const. art. I, § 8, cl. 3.

[7] "The Congress shall have the Power . . . To regulate Commerce with foreign Nations . . . ." U.S. Const. art. I, § 8, cl. 3.

Constitution], and those who were capable of estimating the influence of commerce on the prosperity of nations, perceived the necessity of giving the control over this important subject to a single government." *Id.* at 446.[8] It is against this backdrop of heightened constitutional concern over relations with foreign nations that the propriety of state taxing actions must be assessed.

A. Under the Foreign Commerce Clause, the Proper Subject of Inquiry Is Whether a State Law Discriminates Against Foreign Commerce in Favor of Domestic *or* Local Interests

The foreign commerce clause theory adopted by the court below is based on two premises: only discrmination that is demonstrated to favor local commerce violates the *interstate* commerce clause; and the same showing of local benefit at foreign expense is required under the *foreign* commerce clause. Pet. App. 7a. Based on these assumptions, the court below found that Iowa's discrimination against foreign commerce was not invidious, because the tax scheme did not directly benefit purely local interests.

Both premises, however, are mistaken. First, a showing of purely local benefit is *not* the *sine qua non* of invidious discrimination—even against interstate commerce. Instead, any state statute that facially discriminates

[8] Indeed, the foreign commerce clause is only one of many provisions restricting state power over foreign affairs. Compare, *e.g.*, U.S. Const. art. I, § 8, cl. 1 (Congress has power to collect "Duties" and "Imposts") with *id.* art. I, § 10, cl. 2 (prohibiting states from "lay[ing] any Imposts or Duties on Imports or Exports," except for purposes of inspection, without congressional consent); *see also, e.g., id.* art. II, § 2, cl. 2 (President has the authority to make treaties with foreign nations (with the advice and consent of the Senate)) and *id.* art. I, § 10, cl. 1 (prohibiting states from entering into any "Treaty, Alliance, or Confederation"); *id.* art. I, § 10, cl. 3 (prohibiting states from, *inter alia*, laying duties of tonnage or entering into agreements or compacts with other states or countries, without congressional assent).

against interstate commerce is presumptively invalid: "facial discrimination by itself may be a fatal defect, regardless of the State's purpose . . . . At a minimum such facial discrimination invokes the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives." *Hughes v. Oklahoma*, 441 U.S. 322, 337 (1979).

This Court has made it quite clear that state statutes which facially discriminate against interstate commerce are subject to the most exacting scrutiny, regardless of whether they favor local businesses relative to their interstate competitors. "When a state statute directly regulates or discriminates against interstate commerce, *or* when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry." *Brown-Forman Distillers v. N.Y. Liquor Authority*, 476 U.S. 573, 579 (1986) (emphasis added).[9]

Furthermore, even if a demonstration of local benefit were necessary in order to render discrimination against interstate commerce invidious and impermissible, such a showing is not necessary—and indeed makes very little sense—under the *foreign* commerce clause.[10] The Iowa

[9] *See also, e.g., Hughes v. Oklahoma*, 441 U.S. 322, 337 (1979); *Armco Inc. v. Hardesty*, 467 U.S. 638, 644 (1984) (rejecting the state's contention that the Court should require Armco to prove that the state's tax "results in a total burden higher than that imposed on Armco's competitors in" the state); *Philadelphia v. New Jersey*, 437 U.S. 617, 626 (1978) (rejecting as irrelevant New Jersey's claim that "no New Jersey commercial interests stand to gain advantage over competitors from outside the state" because of the State's discriminatory ban on importation of out-of-state solid and liquid waste).

[10] In each case on which the State relies, this Court was applying the *interstate* commerce clause, which was designed to counteract the interstate protectionism that had occurred prior to the adoption of the Constitution. *Supra* p. 6. When a state statute impermissibly discriminates against interstate commerce, the statute almost invariably confers a local benefit at the expense of inter-

supreme court failed to recognize that the interstate commerce clause and foreign commerce clause have different objects (*supra* pp. 6-7), and therefore condemn different types of discrimination.

When a business engaged in foreign commerce shoulders the burden of discriminatory taxation and alters its behavior to the detriment of such commerce, it is of no moment that the discrimination does not benefit local businesses. And a state's wrongful interference with the free flow of foreign commerce is not lessened in the least if state law benefits domestic commerce generally, instead of local interests specifically. Therefore, when this Court has evaluated state laws that discriminate against foreign commerce, it has not focused on whether purely local interests have been advanced by the law.

In *Cook v. Pennsylvania*, 97 U.S. 566 (1878), for example, the Court invalidated statutes that imposed selective taxation on goods of foreign growth or manufacture sold at auction. The Court noted that the effect of the laws was that by the first statute "a discrimination of one-fourth of one per cent is made against foreign goods sold at auction" relative to domestic goods, and that by the second statute, "while all sales of foreign or imported goods [were] taxed, those arising from groceries, goods, wares, and merchandise of American growth or manufacture [were] exempt from such tax." *Id.* at 569-70. The Court found that this discrimination against foreign commerce in favor of domestic goods was impermissible: "If a tax assessed by a State injuriously discriminating against the products of a State of the Union is forbidden by the Constitution, a similar tax against goods imported from a foreign State is equally forbidden." *Id.* at 573.

And in *Hale v. Bimco Trading, Inc.*, 306 U.S. 375 (1939), a Florida statute imposing an inspection and fee

state commerce. *See, e.g., Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 268 (1984); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977).

on cement imported from foreign countries, but exempting domestic cement, was also found to violate the foreign commerce clause. This Court noted that it had been given "no reason resting in local conditions for what appears to be a transparent discrimination in the imposition of heavy inspection fees as between imported and domestic cement . . . ." *Id.* at 380. Thus, the Court unanimously concluded that such "discrimination against foreign commerce" was repugnant to the foreign commerce clause: "[s]uch assumption of national powers by a state has, ever since March 12, 1827 (*Brown v. Maryland*, 12 Wheat. 419), been found to be in collision with the Constitution." 306 U.S. at 380.

Iowa's theory is not only inconsistent with authority, but also with the inherent logic of the foreign commerce clause. Curiously, under the theory adopted below, the more a state sought to act as an arbiter of United States foreign commerce by purporting to advance non-local domestic or national economic interests, the greater its power would be to permissibly discriminate against foreign commerce. Thus, contrary to logic, the more *national* the state's concerns advanced through discriminatory legislation, the less it would risk impermissibly interfering with the federal government's power to regulate foreign commerce. Under this convoluted approach, Iowa could tax foreign-source dividend income at a rate ten times greater than domestic-source dividend income in order to foster *domestic* industry generally, since it would not directly advance purely parochial interests. Yet the State's protectionist approach is as equally served by the theory that a rising tide raises all ships as it is by legislation directed exclusively toward local business.

If this Court were to find that states are free to discriminate against foreign commerce so long as local interests are not thereby advanced, it would signal a substantial retreat from the consistent protection this Court has afforded foreign commerce. *See Japan Line,*

Ltd. v. County of Los Angeles, 441 U.S. 434 (1979).[11] The only correct approach—applied by this Court in the *Cook* case, *supra*—is that state taxes that discriminate against foreign commerce violate the foreign commerce clause, whether or not purely local interests are favored by the discrimination.[12]

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[11] In *Japan Line*, the Court held that when a state tax is examined under the foreign commerce clause, "a more extensive constitutional inquiry is required" than in interstate commerce clause cases, even if—as was the case in *Japan Line*—the state statute does not discriminate against foreign commerce. 441 U.S. at 445. The Court found that when foreign commerce is at stake, it must also inquire whether the "enhanced risk of multiple taxation" and the possibility that the state tax "may impair federal uniformity in an area where federal uniformity is essential" require invalidation of the tax at issue. *Id.* at 446, 448. Under this more rigorous test, the tax in *Japan Line* failed to pass constitutional muster *despite* its nondiscriminatory character. *Id.* at 444, 448.

[12] The United States argued in its brief at the petition stage that Iowa's discriminatory treatment of foreign-source income "does not necessarily imply that the total income stream of a foreign subsidiary is subjected by Iowa to a greater or lesser total tax burden than that of a domestic subsidiary of the same unitary enterprise." Brief for the United States as *Amicus Curiae* at 9. The United States speculated that the interaction of Iowa's taxing scheme with those of other jurisdictions may in fact place a greater aggregate tax burden on "domestic corporate income" than on foreign-source income. *Id.* at 9 n.9. That inquiry, however, is irrelevant: this Court has noted that "[its] conclusion that a tax facially discriminates against interstate commerce need not be confirmed by an examination of the tax burdens imposed by other States . . . ." *Tyler Pipe Industries v. Washington Dept. of Revenue*, 483 U.S. 232, 247 (1987).

Finally, mere speculation is *all* this Court has been offered in defense of the State's tax scheme: neither the State nor the United States has demonstrated that the State's facially discriminatory tax scheme *actually* imposes no net discriminatory burden on foreign commerce.

B. The State's Rationale for Discriminating Against Foreign Commerce Fails To Approach the Level of Justification Required To Save Discriminatory State Laws

The State alternatively argues that its discriminatory treatment of foreign-source income can be justified by administrative convenience. Opp. 17. But again the State's analysis is flawed. Under *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988), upon which the State relies, as well as *Limbach*'s predecessors, the State's purported justification for discriminating against foreign commerce cannot pass constitutional muster.

The State's selective quotation from *Limbach*, that "state statutes that clearly discriminate against interstate commerce are routinely struck down . . . unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism . . . ." (Opp. 16), omits two important aspects of the Court's test of justifications that would save discriminatory laws. Both are fatal to the State's argument.

First, the *Limbach* Court noted that "the standards for such justification [of discriminatory laws] are high." 486 U.S. at 278. In fact, the Court noted in *Limbach* that "'facial discrimination by itself may be a fatal defect' and '[a]t a minimum . . . invokes the strictest scrutiny.'" *Id.* at 279 (quoting *Hughes v. Oklahoma*, 441 U.S. at 337). Thus, this Court has invalidated discriminatory state laws despite claims that the discrimination was justified by many important state interests including, *inter alia*, promoting the sanitation of milk or meat products,[13] protecting consumers against banking fraud and financial instability,[14] preventing consumer confusion,[15] and conserving natural resources.[16] In fact, our research has disclosed only one case in which a state law has met the *Limbach* test. In *Maine v. Taylor*, 477 U.S. 131, 141, 143 (1986), a ban on importation of live baitfish was upheld because the State *proved* that its wild fish could be infected by parasites common only in out-of-state baitfish, that its aquatic ecology could be disturbed by inadvertent importation of other non-native species of fish along with out-of-state baitfish, *and* that "less discriminatory means of protecting against these threats were currently unavailable."

Compared to the host of important state interests that this Court has deemed insufficient to save discriminatory state laws, Iowa's justification for discriminatory treatment of foreign-source income is weak indeed. Iowa justifies its discrimination as "a byproduct" of its decision to utilize federal tax returns "as the starting point for computation of net income for Iowa tax purposes." Opp. 17. Reference to a taxpayer's federal tax return is convenient and inexpensive, the State argues. *Id.*

The court below accepted this argument, stating that the State's discrimination was permissible because

> [t]he taxpayer is permitted to merely lift the figures off the federal return and transfer them to the Iowa franchise tax return . . . . [The Iowa scheme] prevents the taxpayer from spending time and money on complex forms, provides a saving to the state, allows the state to rely on federal regulation and interpretation, and provides the state with an inexpensive and quick way of verifying the accuracy of taxpayers' returns.

Pet. App. 9a-10a.

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[13] *Dean Milk Co. v. Madison*, 340 U.S. 349 (1951); *Minnesota v. Barber*, 136 U.S. 313 (1890).

[14] *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1980).

[15] *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333 (1977).

[16] *Hughes v. Oklahoma*, 441 U.S. 322 (1979); *Philadelphia v. New Jersey*, 437 U.S. 617 (1978).

But this Court has made it abundantly clear that mere administrative convenience is insufficient to protect a discriminatory state law against challenge. "State restrictions inimical to the commerce clause should not be approved simply because they facilitate in some measure enforcement of a valid tax." *Toomer v. Witsell*, 334 U.S. 385, 406 (1948); *see also, e.g., Halliburton Oil Well Cementing Co. v. Reilly*, 373 U.S 64, 74 n.9 (1963) (rejecting administrative convenience as justification for discrimination against out-of-state companies); *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 354 n.9 (1977) (rejecting State's contention that burdens imposed on interstate commerce by apple labeling regulation were justified "on the ground that the standardization required by the statute serves the national interest in achieving uniformity in the grading and labeling of foodstuffs").

Iowa seeks some special protection in the fact that it has borrowed portions of the federal tax code. However, just as this Court has noted that "[a]bsent some explicit directive from Congress, we cannot infer that treatment of foreign income at the federal level mandates identical treatment by the States" (*Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 448 (1980)), a state's *adoption* of provisions from the "federal level" as its own does not insulate the laws from scrutiny under the foreign commerce clause. And picking and choosing from the federal statute so as to work facial discrimination against foreign commerce, as Iowa has done here, cannot gain credibility from the source of the materials.[17]

[17] Moreover, it is incorrect for Iowa to imply that, in discriminating against dividends from foreign corporations, Iowa is simply mimicking federal law. The provisions of federal law that subject dividends from foreign, but not domestic, subsidiaries to federal taxation have meaning only in the context of those *other* provisions of federal law that provide United States corporations with a credit for foreign taxes paid by their subsidiaries. This credit is designed precisely to eliminate the harsh treatment of foreign corporations that would otherwise result. Iowa law contains no such mechanism. Of course, even if it were true that Iowa simply mimicked federal law in discriminating against income from foreign commerce, this fact would be of no moment. Although the federal government may be free to discriminate against foreign commerce if it wishes to do so, a state government is not.

The State's justification here also fails the second test of *Limbach*: the State must prove that its legitimate interests "cannot be adequately served by reasonable nondiscriminatory alternatives." *Limbach*, 486 U.S. at 278; *Hughes v. Oklahoma*, 441 U.S. at 336; *Hunt*, 432 U.S. at 353. The State has not even attempted to demonstrate that its adoption of a portion of the federal tax code actually promotes administrative convenience, and that this goal could not be achieved without discriminating against foreign commerce. As discussed below, *infra* p. 18, the State's highly speculative interest in administrative convenience does not withstand even the slightest inquiry.

II. THE IOWA TAX TREATMENT VIOLATES THE GUARANTEES OF THE EQUAL PROTECTION CLAUSE

Even if Iowa's taxing scheme did not violate the foreign commerce clause, it would still run afoul of the equal protection clause.[18] The equal protection clause is designed to assure that "all persons similarly circumstanced shall be treated alike." *Royster Guano Co. v. Virginia*, 253 U.S. 412, 415 (1920). Iowa treats companies that earn dividends from foreign subsidiaries in a

[18] "Equal protection restraints are applicable even though the *effect* of the discrimination . . . is similar to the type of burden with which the Commerce Clause also would be concerned." *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 881 (1985) (emphasis in original). The two clauses have different functions. The foreign commerce clause protects international commerce, while the equal protection clause protects persons and corporations from unconstitutional discrimination by the states. *Id.*

manner different from—and more harshly than—companies that earn dividends from domestic subsidiaries, creating an unconstitutional classification. The court below held that Iowa's claim of "administrative convenience" justified the discriminatory treatment of foreign source income, but that conclusion is untenable.

A. Even Assessed Under a Rational Basis Standard, the Iowa Business Tax Violates the Equal Protection Clause

In assessing whether disparate treatment in a taxing scheme violates the equal protection clause under rational basis scrutiny, the "classification 'must rest upon some ground of difference having a fair and substantial relation to the object of the legislation.'" *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 527 (1959) (quoting *Royster Guano Co. v. Virginia*, 253 U.S. at 415). The classification here is, of course, whether the dividend income is domestic or foreign. The object of the legislation, it is claimed, is administrative convenience.

This justification, however, cannot satisfy even the most minimal level of scrutiny under an equal protection analysis. In equal protection cases upholding discriminatory taxes on the ground of "administrative convenience," the burdens at stake have gone well beyond altering a tax form. For example, in *Fernandez v. Weiner*, 326 U.S. 340 (1945), this Court rejected a challenge to an estate tax on community property that did not reach non-marital arrangements. There, "administrative convenience" justified "imposing a tax on a well recognized and defined class" and not extending it "so as to embrace a penumbra of special and more or less casual interests in which each case may or may not resemble the taxed class." *Id.* at 360-61.

Administrative convenience may also justify taxes that apply, for example, only to businesses employing more than a particular number of employees. *See Carmichael v.*

Southern Coal & Coke Co., 301 U.S. 495, 510-512 (1937). In addition to noting that this sort of distinction is commonplace in the law (*id.* at 510), the Court recognized that "the expense and inconvenience of collecting the tax from small employers [might well be] disproportionate to the revenue obtained." *Id.* at 511. No similar benefit is alleged to exist here, and the benefit that actually is claimed is inconsequential.

In *WHYY v. Glassboro*, 393 U.S. 117 (1968) (per curiam), this Court struck down a state tax classification under equal protection in the face of a claim similar to Iowa's assertion of "administrative convenience." There, New Jersey denied out-of-state nonprofit corporations the tax exemptions accorded to in-state nonprofit corporations. A claim of "administrative convenience" could not legitimize this discrimination—New Jersey had only to provide an out-of-state corporation "an opportunity equivalent to that of a domestic corporation to demonstrate that it meets the requirements for a nonprofit corporation under local law." *Id.* at 120.

In this case, as in *WHYY v. Glassboro* above, any perceived administrative burden would be eliminated simply by treating unitary businesses alike, regardless of the situs of the subsidiary providing dividend income. And that equality of treatment is hardly difficult to achieve. In Iowa, the use of federal taxable income is only the beginning of arriving at taxes owed. From that figure, thirteen separate adjustments are made to determine the proper tax base for Iowa purposes. Iowa Code Ann. § 422.35 (West 1990 & Supp. 1991). Iowa has provided no reason why another—for foreign dividend treatment—cannot be added to achieve equal treatment of foreign- and domestic-source income. Iowa's "administrative convenience" argument is especially contrived in the current instance. The tax treatment at issue applies only to corporate taxpayers holding interests in corporate subsidiaries abroad. The State has not demonstrated that the

number of such tax returns is significant, particularly in relation to the total number of tax returns filed in Iowa each year.

What Iowa's claim of administrative convenience amounts to is its unwillingness—for no apparent reason—to alter its existing tax form. We are aware of no decision of this Court finding a state's interest in using a particular tax form sufficient to justify blatant discrimination. Indeed, if such minimal justification sufficed to uphold a discriminatory tax, then there would be virtually no circumstance under which a tax could ever be held unconstitutional under the equal protection clause. It is always easier for state taxing authorities to maintain the status quo and to continue using established forms than to reprint the forms and eliminate the discrimination. Indeed, this Court has invalidated a taxing scheme that precluded out-of-state property owners from demonstrating their nonprofit status,[19] but certainly limiting the number of nonprofit forms the state must process would be more convenient for the state.

In fact, the purported justification of administrative convenience in this case is so insubstantial that it borders on the pretextual. What really appears to be involved here is Iowa rather plainly favoring domestic commerce over foreign commerce—"the very sort of parochial discrimination that the Equal Protection Clause was designed to prevent." *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 878 (1985). Although the federal government, due to its power over foreign commerce, may have a substantial and permissible basis for discriminating between foreign and domestic subsidiaries, the states do not. In *Metropolitan Life*, this Court made plain that under the equal protection clause, states cannot favor domestic over foreign business. *Id.* at 883. Iowa is therefore precluded from articulating this rationale for its facially discriminatory treatment of foreign-source income, leaving it only the claim of administrative convenience. Here, as in *WHYY*, this administrative convenience rationale is plainly insufficient.[20]

[19] *See WHYY v. Glassboro*, 393 U.S. 117 (1968).

B. State Tax Schemes that Distinguish Between Domestic and Foreign Sources of Dividend Income Are Subject to a Closer Look Under the Equal Protection Clause

Even if the Iowa scheme could withstand Kraft's equal protection claim under rational basis scrutiny, the Court should take a closer look. This conclusion is required due to the nature of the constitutional right at stake and the related inability of ordinary political processes to redress this unfair discrimination. When viewed in this light, Iowa's scheme is clearly impermissible.

While states are ordinarily accorded wide latitude in determining what and how to tax (*see Ohio Oil Co. v. Conway*, 281 U.S. 146, 159 (1930)), this Court has long made clear that a close judicial look is required where a discriminatory taxing scheme implicates other constitutional rights. Thus, in *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356 (1973), for example, it was appropriate to measure under the rational basis standard a state tax on personal property that applies to corporations, but not individuals, only because "no specific federal right, apart from equal protection, [was] imperiled." *Id.* at 359 (footnote omitted). By contrast, a more exacting equal protection analysis is required where a tax implicates another constitutional right. "Classic examples are the taxes that discriminated against . . . interstate commerce (*see Michigan-Wisconsin Pipe Line v. Calvert*, 347

[20] *Cf. Minnesota v. Cloverleaf Creamery*, 449 U.S. 456, 463 n.7 (1981) ("[i]n equal protection analysis, the Court will assume that the objectives articulated by the legislature are the actual purposes of the statute, unless an examination of the circumstances forces us to conclude that they 'could not have been a goal of the legislation' ").

U.S. 157 [(1954)]) or required licenses to engage in interstate commerce." *Lehnhausen*, 410 U.S. at 359 n.3.

Similarly, the veteran's preference at issue in *Attorney General of New York v. Soto-Lopez*, 476 U.S. 898 (1986), which implicated both the equal protection clause and the constitutionally protected right to travel, was subjected to an enhanced scrutiny.

> Whenever a state law infringes a constitutionally protected right, we undertake intensified equal protection scrutiny of that law. . . . It is well established that . . . where a law classifies in such a way as to infringe constitutionally protected fundamental rights, heightened scrutiny under the Equal Protection Clause is required.

Id. at 904, 906 n.6 (plurality opinion) (citations omitted).[21] Even when the Court uses the terminology of rational basis scrutiny, it should and does take a closer look when another right is at stake. *See Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985) (interstate commerce); *Hooper v. Bernalillo County Assessor*, 472 U.S. 612 (1985) (right to travel); *Williams v. Vermont*, 472 U.S. 14 (1985) (same).[22]

The classification in the Iowa taxing scheme—distinguishing between foreign- and domestic-source income—implicates foreign commerce, an undeniable concern of the Constitution. The right to engage in foreign commerce is surely as important as its interstate counterpart.

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[21] By contrast, because of Congress's authority to legislate in relation to foreign commerce, a distinction made by the federal government in these circumstances would not necessarily trigger this closer scrutiny.

[22] *Cf. Exxon v. Eagerton*, 462 U.S. 176 (1983). In *Eagerton*, an equal protection claim was accompanied by a preemption claim. Because the latter claim is based on the supremacy clause (U.S. Const. art. VI, cl. 2) which, unlike the commerce clause, confers no substantive rights (*see Dennis v. Higgins*, 111 S.Ct. 865, 870-72 & n.8 (1991)), there was no need for a closer look at the proffered justifications.

See Dennis v. Higgins, 111 S.Ct. 865, 870-71 (1991) (commerce clause "confer[s] a 'right' to engage in interstate trade free from restrictive regulation"); *Cruther v. Kentucky*, 141 U.S. 47, 57 (1891) ("[t]o carry on interstate commerce is not a franchise or privilege granted by the State; it is a right which every citizen of the United States is entitled to exercise under the Constitution and laws of the United States"); *Garrity v. New Jersey*, 385 U.S. 493, 500 (1967) (engaging in commerce is a "right[] of constitutional stature"). Where, as here, a statute on its face discriminates against foreign commerce, it is appropriate for a court to take a close look at the proffered justifications. *Cf. Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. at 446 (presence of foreign elements in a commerce clause claim mandates "a more extensive constitutional inquiry").

The importance of a close look in this case is reinforced by the political dynamic involved in state taxation of out-of-state businesses. Traditional judicial deference under the rational basis test reflects a presumption that legislators will not unfairly favor one class of persons over another—presumably the political process will serve as a check on such improper regulation.[23] But the political process rationale is inapplicable when legislators are not politically accountable to those subject to the legislation. Discrimination against such non-participants in the political process requires a closer look "because such discrimination is unlikely to be soon rectified by legislative means." *Cleburne v. Cleburne Living Center, Inc.*, 473 U.S. 432, 440 (1985). *See United States v. Carolene*

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[23] *See Schweiker v. Wilson*, 450 U.S. 221, 243 (1981) (Powell, J., dissenting) (judicial deference to legislative enactments "rests in part upon the principle that the political process of our majoritarian democracy responds to the wishes of the people"). *Cf. Leathers v. Medlock*, 111 S. Ct. 1438, 1443 (1991) ("[G]eneral applicability of any burdensome tax law helps to ensure that it will be met with widespread opposition. When such a law applies only to a single constituency, however, it is insulated from this political constraint").

Products Co., 304 U.S. 144, 152-53 n.4 (1938) ("legislation which restricts those political processes which can ordinarily be expected to bring about repeal of undesirable legislation [may] be subject[] to more exacting judicial scrutiny").

Because of the relative political impotence of out-of-state corporations and the importance of the right at stake, statutes that facially discriminate against foreign commerce are not entitled to a presumption that the state is not arbitrarily preferring one class over another.[24] This principle applies not only to foreign corporations, but also to multinational corporations, which are less likely to be viewed as local in character or have the political influence of wholly domestic entities. In state tax cases the Court has often recognized that "to the extent that the burden of state regulation falls on interests outside the state, it is unlikely to be alleviated by the operation of those political restraints normally exerted when interests within the state are affected." *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 767-68 n.2 (1945). *See McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 45-46 (1940). The absence of political power of out-of-state interests gives rise to the possibility—if not the probability—that a state's rationale for a discriminatory classification is pretextual. *See supra* p. 19.

Even if the Iowa taxing scheme passed "rational basis" scrutiny, therefore, it would still violate equal protection under the closer look warranted by virtue of the right at

[24] *See Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 649-50 (1981) (Blackmun, J., dissenting) (absence of political checks when legislature not politically accountable to those it taxes justifies special judicial scrutiny); *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 675-76 (1981) (Powell, J.) (plurality opinion) ("[l]ess deference to the legislative judgment is due" when resident-favoring exemptions weaken the natural presumption that "a State's own political processes will serve as a check against unduly burdensome regulations").

stake and the political dynamic involved here.[25] Under this closer look, Iowa's purported interest—administrative convenience that can be readily accommodated by the simple expedient of altering its tax forms—could not possibly save the State's taxing scheme from invalidation on equal protection grounds.

CONCLUSION

The decision of the Iowa supreme court should be reversed.

Respectfully submitted,

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March 6, 1992

[25] This sort of "close look" would apply only in a limited class of equal protection challenges to state taxing schemes. Many state taxes so challenged have no foreign (or even interstate) component.